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INTERAGENCY INTELLIGENCE ASSESSMENT

29 January 1987

THE PHILIPPINES: NEAR-TERM PROSPECTS FOR STABILITY AND US INTERESTS

This Interagency Intelligence Assessment was prepared under the auspices of the National Intelligence Officer for East Asia. The Assessment was coordinated at the working level within the Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the Intelligence organization of the Department of State. Also participating were the Intelligence organizations of the Departments of the Army, the Navy, and the Air Force, and Headquarters, Marine Corps. Information available as of 26 January 1987 was used in the preparation of this Assessment.

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KEY JUDGMENTS*

We believe President Corazon Aquino's political position in the Philippines has improved somewhat since our last Estimate:

- Mistakes by her opponents and preemptive moves by her supporters have enabled her to take some actions, such as dismissing Defense Minister Enrile and replacing Labor Minister Sanchez, that lend an aura of strength to her government.
- The commencement of a 60-day cease-fire has given the government, and especially the New Armed Forces of the Philippines (NAFP), a breathing spell.
- The likely approval of the new Constitution in February will lend legitimacy to her rule.

Nevertheless, many obstacles--such as the continuing violence from the extreme right and left witnessed in recent weeks--remain to the consolidation of her government and progress toward the achievement of political stability. We believe that she will face particularly significant challenges in these areas:

- Formulating and implementing a national agenda.
- Coping with new legitimate sources of opposition after congressional elections in May and local elections in August, and reconciling diverse interests in formulating policy.
- Controlling a military that remains wary of her policies, and that has already tasted some of the fruits of limited intervention. Should Aquino further alienate the military, we would expect renewed attempts at greater military intervention.
- Creating a broad political base through an organized political party, both because of her own temperament and because of the personality-oriented and factionalized nature of Philippine politics.

*The Bureau of Intelligence and Research concurs in the description of the problems facing President Aquino and in the need for a cautious prognosis at this stage in the Philippine transition. It also believes, however, that the Key Judgments considerably understate the long-term benefits of the type of leadership so far demonstrated by President Aquino and, in particular, fails to give adequate weight to her popularity, which underpins the process of institutionalization now under way. Only after the milestones of the plebiscite and the congressional elections are past will she have the opportunity to deal more fully with the issues of governance upon which the success of the transition will ultimately depend.

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Consequently, our prognosis for the Philippines over the next two years is mixed. We believe that there will not be substantial progress in achieving government unity or in creating a greater degree of order and stability even with the adoption of the new Constitution and the holding of local elections. The efforts of Aquino's political foes to pose legitimate opposition to her policies will further test her ability to compromise and will result in a further slowdown of her government's ability to get things done. Unless she is able to consolidate her own political machinery to challenge her opponents in elections, a highly uncertain prospect in our view, her government will probably continue to muddle along.

We also believe that the rapid deterioration and disintegration of political stability, which characterized the Marcos era, have been halted--barring developments such as a military coup, unanticipated Communist advances, or the assassination of Aquino. The Aquino government has overcome the worst features of the Marcos era, but it will be likely to do little in coming to grips with the pressing longer range problems of political, economic, and social justice in the countryside.

The economy is not likely to improve significantly during the period of this Assessment. Potential gains are likely to be offset by potential difficulties. Nevertheless, we believe that Aquino's economic approach is more likely to stimulate public confidence than was Marcos's, and that over time there is a good prospect for economic improvement provided her government holds firm to its present course.

Time, unfortunately, could play into the hands of the Communist insurgency. Many rural areas, from which the insurgents derive much of their support, will continue to experience political tensions, economic deprivation, and a popular perception that not enough attention is being paid to their problems by the central government. We have evidence that the number of villages either controlled or influenced by the Communists is increasing. The Communists will continue to try to play on this situation to develop strength, and they will continue to be a threat to the regime.

The Communists also have weaknesses, however, that could be exploited if a sound, balanced civilian-military counterinsurgency strategy were to be applied. The Communists are experiencing disunity over whether to accept the Constitution and to participate in elections through front organizations, or to maintain an armed struggle against the regime. The Communists are also beset by personality differences. Nevertheless, while there has been more talk about counterinsurgency, and the government has taken some steps that strengthen counterinsurgency potential, we remain pessimistic because we believe that an effective, coordinated counterinsurgency will not be undertaken, particularly at the local level. We believe the current Aquino strategy of combining an amnesty with a cease-fire will not be successful in attracting large numbers of insurgents to defect and will not seriously hurt the insurgents.

The scenario we believe most likely--no substantial improvements in the Philippine situation but also no rapid deterioration--could be challenged by several alternatives:

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- Should Aquino leave office suddenly by military coup, her unexpected resignation, or assassination, there would probably be a destabilizing shift to the right in government policy. A new government might take a more vigorous military approach to counterinsurgency, but almost certainly would also exacerbate political and social tensions upon which the insurgency thrives. We would predict a deterioration of the political situation.
- Should failures of the Aquino government lead to a more rapid growth of Communist power than we now anticipate, the regime could be seriously threatened. Such an alternative scenario would also require that the Communists develop greater unity than we believe they currently have.

For the United States, the situation in the Philippines over the next two years will be particularly challenging. Negotiations over the Military Bases Agreement will be complicated by new constitutional provisions dealing with nuclear weapons, a greater number of participants in the Philippine Government's decision process, and nationalistic posturing by some Filipino politicians. Nevertheless, the primary impetus will be toward the maintenance of the bases beyond 1991. President Aquino and other Philippine leaders, however, will expect continued and even greater US political and economic support including more financial aid.

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DISCUSSION

1. In recent months President Aquino's political position has improved at the expense of rivals such as former Defense Minister Juan Ponce Enrile, Vice President Doy Laurel, and allies of former President Marcos because of missteps by her opponents and preemptive actions in her behalf by supporters. In particular:

- The aborted coup attempt in November by allies of Enrile, and the choice by Armed Forces Chief of Staff Ramos to oppose the effort, discredited much of the political right and removed a thorn in the side of the administration by forcing Enrile's departure from the Cabinet.
- A 60-day cease-fire between the government and Communist insurgents, under way since 10 December, has given the government, and especially the New Armed Forces of the Philippines (NAFP), a breathing spell and has enhanced Aquino's authority and popular image.
- The almost certain passage of a new Constitution in early February will further Aquino's interests by providing the first popularly ratified legal basis for her rule, thus reducing the ease of challenges to her authority.

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2. Aquino's government has changed orientation somewhat as a result of a Cabinet shakeup accompanying Enrile's departure. Aquino has replaced left-leaning Labor Minister Augusto Sanchez, whose ties to several Communist-dominated labor organizations were well known, with Franklin Drilon, a moderate known for his sensitivity to management concerns on labor relations. Controversial Minister of Local Government Pimentel has been moved to a less sensitive post, and the duties of leftists such as Presidential Counselor Renito Saugusag have been somewhat circumscribed. Although Aquino's preference for social-democratic policies has almost certainly not abated, the government is now perceived by many other political players as closer to the political center than previously. It continues, nevertheless, to contain representatives from nearly all elements of the political spectrum, and its coherence and efficiency are still questionable.

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3. The outcome of congressional elections on 11 May will be critical in determining whether Aquino's position strengthens or weakens in the months ahead. The new legislature will convene officially on 30 June, and Aquino will thereafter share power with an upper and lower house that--for the first time during her presidency--will provide a forum for rivals with formally established constituencies whose legitimacy matches her own. Whether the new structure of government functions effectively or diminishes Aquino's power also will depend on her willingness to reconcile with the various forces that will be prominently represented in the new Congress.

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Aquino's Achievements

4. In the 11 months she has been in office, Aquino has strengthened her image internationally and has made progress in consolidating her power at home. As a result:

- Bilateral relations with the United States and Japan have improved because of her pursuit of a reformist agenda and her increased receptivity to closer ties.
- The election machinery established by Marcos has been overhauled and a new legislature will replace the disbanded National Assembly in June.
- A new, moderate Constitution was produced in September by Aquino-appointed delegates.
- Qualified justices have been appointed to the Supreme Court.
- Professional and competent officers have been assigned to senior military command and staff positions.

As a result, we believe that Aquino has made progress in overcoming the worst features of the Marcos regime.

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5. Aquino has also pressed forward with economic reforms. She has:

- Enacted a tax reform package that promises to improve revenue collection and to diminish distortions in resource allocation.
- Formulated plans to rehabilitate the distressed financial system.
- Dismantled agricultural marketing monopolies in sugar and coconut, and announced a priority on rural development.
- Secured \$1.2 billion in new financing from foreign aid donors and a \$500 million loan from the International Monetary Fund (IMF).

6. As part of the tax reform, taxes on consumption have been increased and taxes on exports reduced, and the government plans to institute a value-added tax in 1988. The IMF loan has triggered the release of the last tranche of over \$900 million in commercial bank financing agreed to during negotiations under Marcos to reschedule foreign debt principal repayments that fell due in 1985 and 1986. The government also has formulated plans to privatize money-losing state enterprises such as the national oil company and the national airline, and created a facility to convert the foreign debt of the private sector to equity shares for foreign investors. If adhered to, these policies would contribute to long-range economic recovery in the Philippines.

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Aquino's Weaknesses

7. Offsetting many of Aquino's accomplishments are shortcomings that could yet prove fatal to her administration. These include:

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- An unimpressive record of choosing advisers. Aquino has presided over a stormy Cabinet that she changed only as a last resort following last November's aborted coup attempt. Aquino's Executive Secretary and principal adviser, Joker Arroyo, has alienated many would-be allies and proved to be an obstacle to the political, economic, and military reform initiatives. Two ministers, Minister of Natural Resources Maceda and Minister of Public Works Mercado, have been removed because of allegations of corruption, but Aquino's brother and close political adviser Peping Cojuangco is widely perceived to be engaged in illegal rakeoffs and economic favoritism to finance his own political ambitions. Although Aquino's personal integrity is not in question, the corruption issue has cost her political capital, and it even prompted public criticism from Manila's Cardinal Jaime Sin, one of her earliest and most prominent boosters.
- A reticence in decisionmaking. Aquino has allowed critical problems to fester for long periods. A national program intended to generate up to 1 million jobs, for example, remains slowed by bureaucratic infighting that Aquino appears reluctant to resolve. Her leadership in the constitutional convention was criticized by many of her staunchest allies, and last minute maneuvers were required to head off initiatives by radical delegates. Aquino also tends to delegate policymaking to unproven subordinates rather than become involved with the details of issues.
- A distaste for practical political compromise and seeming disinterest in establishing a political machine. Aquino still lacks a functioning political party, and she has yet to endorse explicitly the efforts of her brother and other advisers to establish the apparatus of Lakas ng Bansa (LAKAS), an organization they intend to carry the Aquino banner in the congressional elections in May. This could be critical to her political fortunes with the new Congress, especially considering the checks on executive authority contained in the new Constitution. Consequently, we believe that her government will continue to experience difficulty in consolidating its authority.

The Unsettled Military

8. Aquino shares the political limelight with a politically divided military that harbors many reservations about her leadership and policy orientation. The threat of military intervention against her has been reduced in the near term by the firing of Enrile and the disbanding of the Ministry of National Defense Security Group which formed his power base. The decision by Ramos and his service chiefs to oppose coup attempts by segments of the military as recently as 26 January, and the military's straightforward adherence to the guidelines of a 60-day cease-fire with the Communists, despite their reservations about the outcome, confirm that the senior military command is committed to Aquino for now.

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9. Nevertheless, the situation is tenuous. Many of the military's grievances on which Enrile attempted to capitalize, such as concerns over counterinsurgency strategy, Aquino's ideological bent, and alleged Communist infiltration of her government, remain. Moreover, the issuance to Aquino last

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fall of a 10-point "Statement of Concern" (See Annex) summarizing the policy preferences of Ramos and the service chiefs indicates that reservations about Aquino and her government were not confined to Enrile and his supporters.

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10. Several factors will determine future military attitudes. Most important will be Aquino's conduct of a counterinsurgency strategy, her sensitivity to military reservations about extending the cease-fire, her willingness to follow through with the policy recommendations of the Statement of Concern, and the degree to which grassroots organizational work by midlevel officers who made up Enrile's support group is successful. Ramos and Defense Minister Ilete remain determined that Aquino must establish a National Security Council to oversee counterinsurgency strategy, select a moderate sympathetic to the military to head the body, and establish a body to investigate the civil rights abuses by Communist rebels. Failure by the administration to meet these concerns could place Ramos, Ilete, and the service chiefs in a delicate position with the portion of the officer corps that harbors the most serious reservations about Aquino. Should Aquino further alienate the military, we would expect renewed attempts at greater military intervention.

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The Non-Communist Opposition.

11. The abolition of the National Assembly and the lack of electoral activity since Aquino came to power have deprived conservative forces opposed to Aquino of a platform on which to base organization efforts, and accordingly they remain in disarray. Despite a regional base in northern Luzon, Marcos's old Kilusang Bagong Kipunam (KBL) party has been discredited by failed coup attempts and has been successfully denied power by Aquino. Organizational attempts by more independent-minded former allies of Marcos have been largely designed to establish personal political machines and, as such, have shallow roots. For example, an attempt by former Labor Minister Ople to organize other remnants of the KBL into a new organization, the PNP, has accomplished little thus far.

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12. The development of a politically significant party in opposition to Aquino is unlikely to precede the May elections. Thus far, opposition alliances appear short-term tactical arrangements over individual issues, and there is little precedent in Philippine political history for parties organized around ideology or program. Aquino's opposition formed a new umbrella group, the Coalition for Democratic Action, to encourage a "no" vote on the constitutional plebiscite. But because the Constitution appears likely to be approved easily by the electorate, and because many opposition politicians appear to believe its failure to pass would defer the elections they eagerly await, opposing the Constitution will not produce a cohesive, enduring opposition organization. We believe that the Constitution will be ratified by a substantial majority.

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13. Several prominent figures will have some success assembling personal political machinery in the months ahead, and they are bound to retain allies in the new Congress under almost any likely electoral outcome. Enrile has maintained links with the Nationalista Party and is attempting to serve as a unifying figure for the opposition at large. At the same time, Laurel maintains a political organization made up of those portions of United

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Nationalist Democratic Organizataion (UNIDO), the umbrella group that formed the traditional opposition to Marcos and not yet won over by Aquino, and his presidential ambitions are scarcely concealed. Laurel is under pressure from portions of UNIDO to break with Aquino, and he has periodically met with Enrile to discuss political options. They and other opposition figures reportedly retain financial "war chests" to use in the upcoming elections. [REDACTED]

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The Communist Opposition

14. The rise of Aquino threw the Communist Party leadership into disarray because of its decision to boycott the presidential election and because of debates over the strategic question of whether to confront or cooperate with the new leadership. The confusion initially eroded the Party's control over its political front groups and its military wing, the New People's Army (NPA). An ensuing struggle may have produced a more pragmatic leadership inclined to emphasize political organization at the expense of large-scale guerrilla military operations. Accordingly, the Party has created a new political front--the Partido ng Bayan (PNB)--to field candidates in local elections in August. [REDACTED]

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15. The new leadership also appears inclined more to a consensual style of decisionmaking that involves lower level cadre and, thus, requires more time to resolve differences over policy. Nonetheless, the Party has had little trouble enforcing adherence to the cease-fire, and it moved quickly to reassert its dominance over the nation's largest radical labor organization when the assassination of the organization's president created a vacuum in its leadership in December. Though debate over how to deal with Aquino is likely to continue, these developments suggest the Party apparatus itself was not dealt a critical blow by the change in leadership in Manila. [REDACTED]

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16. We lack convincing evidence that the military fortunes of the Communists have increased substantially since Aquino assumed power. Although the NPA may be curtailing recruitment as a matter of policy because of a limited number of available weapons and to fears of penetration by government intelligence, [REDACTED] that NPA "revolutionary tax" collection efforts have increased substantially throughout the country, despite occasional reports of organized resistance in some areas. On the other hand, there is no evidence that the NPA has suffered the large-scale desertions the government had hoped for when it assumed office. That more have not defected is because of a variety of reasons, including a lack of viable programs to incorporate them back into society and a fear of Communist retribution, among others. [REDACTED] places the number of surrenderees at 300 out of an estimated 23,000 guerrilla regulars. [REDACTED]

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17. The Party's principal political organ, the National Democratic Front (NDF), has assumed a significantly higher profile in the more open political environment and moved aggressively to capitalize on peace negotiations with the government during the cease-fire by stepping up propaganda activities. NDF negotiators have appeared frequently on television with government representatives and, according to numerous press reports, have acquired a mantle of legitimacy in the eyes of much of the public. Like the armed forces, the NPA has used the cease-fire to retrain and resupply and does not appear to have determined that the cease-fire damages its interests. [REDACTED]

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18. The Communist leadership may now reason that it has achieved its propaganda objectives. In recent weeks, it has debated the merits of extending the cease-fire and continuing negotiations with Manila, and will adopt whichever course seems most expedient. We believe it is leaning toward a resumption of hostilities. Debate over the best approach, however, will probably preclude the Communists from fully developing a unified strategy and could eventually play into the hands of the government if a well-conceived counterinsurgency strategy were to be employed.

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The Elusive Economic Recovery

19. The economy's external finances have stabilized. The reduction in imports required to turn the trade deficit around in the face of flat export revenues, however, required a contraction in domestic expenditures during 1984 and 1985, and investment outlays have borne the brunt of the adjustment. Philippine Government data suggest investment remains nearly \$4 billion below the level that prevailed in 1981.

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20. There is little evidence that investment or growth are returning to the historical levels hoped for by the government, despite a brief increase in capital good imports last fall. Local business investment and construction during 1986 were one-third below the level of 1985, and foreign investment was down by half. Accordingly, recent data released by the government suggest the economy will register, at best, a growth rate of less than 1 percent for 1986, and per capita income continued to fall. index of Philippine economic activity registered a modest increase early last summer but has been flat since June.

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21. Manila continues to hope that a surge in investment will lead the recovery, and this objective undoubtedly prompted the selection of the moderate Drilon to head the Labor Ministry to calm investor fears of continued labor unrest. Nonetheless, it appears unlikely that businessmen will select the Philippines as an outlet until Aquino has weathered the May elections and the political situation appears more predictable. Manila also will have to complete negotiations with its private creditors over the terms of rescheduling nearly \$8 billion in repayment obligations falling due between 1987 and 1989. Talks, stalled over Manila's insistence on premium terms, are likely to resume in the months ahead.

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22. Manila has planned to increase the budget deficit to \$1 billion this year, nearly 5 percent of GNP, as a method of "kick starting" the economy. The tax reform measures and healthy Central bank reserves--in excess of \$2 billion--suggest such a policy will not immediately endanger Manila's recent progress in restoring its external accounts if coupled with export promotion measures. In our view, however, 3.5-percent growth appears the most in reach for 1987--short of the 6.5 percent believed by the Planning Minister to demonstrate progress to the public, but enough to generate the first improvement in per capita income since 1982. Overall, we are pessimistic that the economy will register substantial improvement in the next two years, though we believe there are prospects for growth over the longer term if the government continues to adhere to sound economic policies.

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The Next Year: Stability ProspectsThe Election Agenda

23. Aquino has used the campaign for the plebiscite on the new Constitution to position herself for congressional races in May. In several campaign stops in early January she has featured allies as potential Senate candidates--who will be elected at large for the 24-member upper house--and she appears to be assembling a "Cory slate" to capitalize on her still widespread personal popularity. Prospects that Aquino's effort will produce a Senate congenial to her administration are good if she continues to personalize the campaign and remains on the stump through the May balloting.

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24. The makeup of the lower house is likely to be more representative of the wide spectrum of political interests active in the provinces, because representatives will be elected by district. The new Constitution provides for 188 elected delegates for the lower house, 24 appointed by accredited political parties, and 24 appointed by Aquino from various population groups. Because existing political parties are weak at the national level, coordination of slates among loyalist and opposition groups is not yet well developed, and local politicians retain personal political machines to advance their ambitions, the lower house will probably strongly reflect regional interests. Remnants of Marcos's old party, and political figures beholden to the Communists, seem certain to win more than a few seats. Altogether, opposition groups could win 60 to 70 percent of the elected seats. Consequently, Aquino's relations with the lower house are likely to be more tenuous than with the Senate.

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25. The political spectrum will be equally well represented in the outcome of elections for local officials--provincial governors, town mayors, and others--on 24 August. The Communists have taken a special interest in the local races, and the PNB is reported to have put a considerable effort into fund raising. The form of Communist participation remains unclear in the wake of a January decision by the Election Commission to deny the PNB accreditation. Even if the PNB cannot field its own candidates, however, the Communists have a good chance of indirectly winning as many as 15 percent of contested seats by reaching accommodations with non-Communist candidates.

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26. The congressional and local elections will change the the makeup of both national and local government. Several of Aquino's current Cabinet members are likely to run for the Senate; thus the administration itself is also likely to change, since Cabinet members are not allowed to serve in both the executive branch and the Congress. The most important impact of the election, however, will be on the rules of national politics in general. The advancement of Aquino's programs will require her to reach compromises with political interests she has thus far been able to ignore. This will require a degree of flexibility and a level of political skill she has not demonstrated during 11 months of rule by decree and other executive prerogatives. If the tradition of the premartial law congress is any guide, there is some prospect that the government would bog down in an unproductive political stalemate, and Aquino's programs would be a casualty.

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27. Aquino could well face the need to enter into a de facto coalition with either the right or the left if these forces do as well as expected in the races for the lower house and local elections. An alliance with the right could jeopardize much of her reformist program. The most politically explosive outcome would be a choice by Aquino to work closely with the left, a circumstance that would severely strain her already fragile relations with the military. The likelihood of this outcome will decrease considerably if Aquino becomes more actively involved in building her own political machinery, which would improve her chances of promoting her own candidates in the lower house.

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28. We believe that over the next two years the efforts of Aquino's political foes to pose legitimate opposition to her policies will further test her ability to compromise and will result in a further slowdown of her government's ability to get things done. Unless she is able to consolidate her own political machinery to challenge her opponents in elections, a highly uncertain prospect in our view, her government will be likely to continue to muddle along. It will have overcome the worst features of the Marcos era, but will probably do little in coming to grips with the pressing longer range problems of political, economic, and social justice in the countryside.

Countering The Communist Insurgency

29. Aquino may desire to use the election schedule to justify to the military extending the cease-fire through much of 1987; the current 60-day agreement expires just after the February plebiscite, and two 90-day extensions would nearly suffice to cover congressional and local elections. Given opposition to the current cease-fire by much of the armed forces and most NPA regional commands, and given ongoing discussions by the NDF leadership on methods of ending the arrangement, it appears unlikely that such an initiative by Aquino would succeed.

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30. The elections, in any case, will bear on the post-cessate-fire tactics of both the Communists and the armed forces. A poor showing by candidates fronting for the Communists in local elections, or the denial of accreditation for the PNB, could be used by Party hardliners to discredit the strategy of political participation, thus reasserting the relative weight of the military role of the NPA in the revolution. At the same time, a good showing by either conservative candidates or leftist forces in the congressional elections could prompt the armed forces leadership to press for more aggressive counterinsurgency operations.

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31. Although the Communists continue to be constrained by a lack of arms and by a decentralized NPA command structure, there is a good chance that the level of insurgent violence will return to previous levels by the end of 1987, particularly in view of the probable maintenance of the basic Communist military apparatus and resupply and retraining efforts that may have enhanced it during the ceasefire. One disturbing development is the recently reported CPP/NPA contact with the North Koreans to acquire arms and guerrilla training. However, a party effort to step up armed activities would test its cohesion and discipline and would probably be resisted by some elements.

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32. We believe that the capabilities of the new Armed Forces of the Philippines have slightly improved over the last 11 months, and the government may be better able to handle renewed violence:

- The military's leadership has been improved with Aquino's appointments of Ramos, Army chief Canieso, Defense Minister Ilete, and Deputy Chief of Staff Mison.
- The availability of supplies in the field is up.
- Troop mobility has improved somewhat because of the redeployment of trucks from the capital to the regional commands.
- Despite dissatisfaction with some Aquino government policies, troop morale is better as a result of a modest pay increase and the new leadership.

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33. Moreover, the removal of several hundred Civilian Home Defense Force personnel charged with abuses of the civilian population has improved the image of the government in the field. Planned changes in training will also help the armed forces, though field capabilities will continue to be seriously constrained by logistic and maintenance bottlenecks, poorly coordinated intelligence, and shortages of helicopters and communications equipment.

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34. The government still lacks a coordinated civilian-military counterinsurgency program. Regarding civic action, Manila plans to establish 12 rebel rehabilitation centers as a means of attracting less committed revolutionaries. The program entails infrastructure development in troubled areas and land acquisition for NPA surrenderees, as well as loans of cash for surrendered weapons. The government envisions \$50 million in funding, but has thus far provided only \$1 million in seed money because of budget constraints, which appear destined to continue because of the sluggish economy. In view of the modest success of a pilot program under way in Mindanao, we believe a fully developed version would somewhat erode NPA forces.

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35. The armed forces have debated alternative counterinsurgency tactics. One concept envisions establishing secure areas conducive to local government machinery in locales where military gains are clearly achievable with redeployed maneuver battalions. A more aggressive option, advocated by Canieso, would apply redeployed forces to Communist strongholds such as the Bicol. Finally, Ramos, until recently, appeared to favor bolstering the Civilian Home Defense Force to augment regular Army operations nationwide.

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36. Because of disagreement among the NAFP high command and within the government, we believe that actual implementation of a well-conceived, well-developed counterinsurgency strategy is unlikely. While there will continue to be lipservice to counterinsurgency, without greater incentives and more money, counterinsurgency will continue to founder as it has in the past. This will work to the advantage of the Communist insurgents.

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Beyond 1987: Keys To The Outlook

37. With neither the government nor the Communists capable of achieving a clear strategic advantage over the next year or so, the outlook for the rest of Aquino's tenure will remain clouded. If Party history is any guide, the Communists are unlikely to make the mistake of forsaking political organization or guerrilla tactics in favor of conventional military strategy, and thus will continue to remain an entrenched force. The armed forces, despite recent improvements, are unlikely to record gains in the effectiveness required to neutralize the NPA. Future stability will be promoted--and US interests protected--to the extent that Aquino succeeds during the next several years in strengthening the political center and laying the foundation for a sustainable economic recovery.

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Strengthening the Political Center

38. The weakness of the political center is underscored by the apparent ease with which the military has recently influenced political developments, the fluidity of political allegiances, the proliferation of private armies, the tenuous state of political organizational efforts, and the dependency of the center on the personal popularity of Aquino for a place in national politics. If Aquino were to depart the scene before the end of her term, the government would most likely shift to the right under the leadership of Vice President Laurel. Given the recent prominence of the military and the likely heavy representation of conservatives in the new lower house, the right would face little opposition to its programs. If the Marcos years are any guide, the rightist programs would be less conducive to political stability than those of Aquino over the longer run.

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39. The political intentions of the armed forces leadership and the military's internal cohesion could prove critical to evolving a new, more stable political order. The NAFP thus far seems committed to allowing the freewheeling political competition sought by Aquino, but would probably prefer to circumscribe political activity within certain, more limited parameters. The Philippine military does not seem likely to seize and exercise power as have its Indonesian or Thai counterparts, but there is little doubt that its role in bringing Aquino to power and active judgment of her progress since has elevated its political role. Army chief Canieso, however, has openly suggested that the Indonesian model of formally integrating the armed forces into the political system may be appropriate for the Philippines. This kind of sentiment could increasingly gain currency among NAFP leaders.

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40. The conduct of Aquino in the new political environment will also weigh on the future of centrist politics. Aquino by all measures is committed to political pluralism and reform. The longer and more successfully she rules, the better will be the chance that successor governments will be constrained to follow her example. If her relationship with the new Congress blocks policymaking, however, Aquino's leadership will fall short of fundamentally changing Philippine politics, or of establishing viable institutions.

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Sustaining Economic Growth.

41. A key to the future of moderate politics is the health of the national economy and the growth of the middle class. The cost of economic stagnation is apparent; unemployment in Manila in 1985, for example, reached 22 percent as national output contracted. To the extent that future growth favors the rural economy, the appeal of the Communist Party in the countryside will be reduced--an outcome Manila seeks to achieve with programs aimed at improving agricultural productivity and diversification, chiefly through policies to improve irrigation, reduce taxes on fertilizer, and invest in rural infrastructure projects such as roads. Thus far, however, these programs have not progressed much beyond the conceptual stage.

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42. Sustained growth will not occur without recovery in investment. One obstacle to investment by foreigners is local nationalism by a vigorous entrepreneurial class that has discouraged competition from foreign firms by lobbying for a relatively complicated system of foreign investment regulations. Further pressure to regulate investment could grow in the new Congress. If there is greater political stability, and thus predictable economic policies, prospects for private capital outlays from either foreigners or local businessmen could be excellent. A large gap has opened up in recent years between wage rates paid in the Philippines and the country's East Asian competitors. Accordingly, a respected US economic forecasting service has recently termed Philippine investment potential "among the most exciting" in the region. Nevertheless, we believe that there will not be significant new investment unless the political situation becomes substantially more stable--unfortunately, a dubious prospect any time soon.

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43. An equally critical issue is whether a surge of investment and growth can occur without leading to a resumption of the country's external financial problems. The current account deficit has improved mainly because of reduction of imports, which will have to increase sharply when growth is resumed. Balance of payments management, according to the World Bank, thus should rely chiefly on export promotion, continued trade liberalization, and adequate depreciation of the exchange rate--which moved in the correct direction during 1986 because it was being passively tied to a deteriorating US dollar--thus financing imports without requiring large amounts of new foreign borrowing. The need to promote exports will be especially critical during the period 1988-95, when an already-heavy foreign debt repayment burden will grow as a result of added repayments resulting from debt rescheduled in the last several years. An added dividend to an aggressive exchange rate policy is the economic impact on the countryside; the World Bank, for example, claims that a depreciation of the peso of 5 percent leads to an increase in rural income of 3 percent.

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44. Because of the multitude of economic constraints, we reaffirm that we see no prospect for extensive economic improvement in the Philippines over the next two years. Nevertheless, because the government is committed to a basically realistic economic program, if it is able to adhere to this commitment, it will be able to establish the basis for better economic performance over the longer term. We are concerned that public pressures could derail the government's economic program, just as happened during the

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Marcos era, and we fear that if this happens there could be rapid economic deterioration. It is vitally important for the Philippines to attract greater investment along with the foreign aid that it must have to remain on track.

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US Interests And US Leverage

45. Because political stability is not assured, US security equities and US financial, trade, and investment interests in the Philippines will remain at risk for at least the next several years. At the same time, near-term US policy options will be constrained by the review of the Military Bases Agreement likely in 1987-88.* While the review in 1982-83 fell far short of a renegotiation, next year's talks will be complicated by the proximity of the 1991 termination date, which will call into question the MBA itself. Prominent figures in the Philippine defense establishment have already informally concluded that the issue of extension should be on the agenda. The discussions will be complicated by the existence of the new Congress, which will consider its own role in the negotiations seriously and feel obliged to demonstrate its nationalist credentials to the public. The new Constitution gives the MBA the status of a treaty, and an agreement will require approval by the majority of the new Senate.

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46. How Manila conducts the negotiations will depend on how involved Aquino chooses to become personally and on the jockeying for position during the next year by those most interested in influencing the process, such as the senior armed forces command, the Ministry Of National Defense, and the Foreign Ministry. Ambassador to the United States Palaez, also plans to play a prominent role. For her part, Aquino is likely to remain preoccupied with electoral politics through August.

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47. The negotiations may well prove another test of the relationship between Aquino and the armed forces. During previous base reviews, the military sought to be as involved as possible and most defense agencies prepared position papers on matters of key concern. These issues are certain to resurface, and will revolve around the level and composition of compensation, Philippine sovereignty over the facilities, and restrictions on US operations at the bases, which could include confirming or denying the presence of nuclear weapons, which the new Constitution appears to prohibit. During the last review, Marcos cut the military out of most of the negotiations and many negotiating positions advocated by the military never surfaced. Attempts by Aquino or a member of her administration such as Palaez to curtail the military's role next year could easily backfire and precipitate another confrontation between the civilians in the government and the senior military command.

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*In January 1979, the United States and the Philippines signed an agreement to the 1947 Military Bases Agreement calling for a "complete and thorough" review every five years until 1991, when it becomes subject to termination by either side with one year's notice. The review is to include a "reassessment of the agreement's objectives, duration, and manner of implementation." Formally, the next review should be signed in January 1989.

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48. Because the review will require more complicated diplomatic negotiations than usual, Washington will face difficulties in resolving its interests in a smooth base review with its interests in prodding the Aquino government to adopt policies that promote stability over the longer term. Philippine sensitivities over perceived US "intervention" in domestic politics could well spill over into the base review, as negotiations with Marcos during the late 1970s demonstrated. We believe that the base review can be successfully negotiated, but that the United States should anticipate greater demands for financial payments and more concessions over access and use of the bases. [REDACTED]

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ANNEX

"STATEMENT OF CONCERN"

1. Operationalize a six-point recommendation on the insurgency:
 - Adopt a national strategy.
 - Reactivate a multiagency secretariat and planning staff.
 - Follow up the cease-fire initiatives with the Moro National Liberation Front and the Cordillera People's Liberation Army.
 - Dialogue with Mindanao leaders.
 - Promulgate policies on amnesty and rehabilitation of returnees.
 - Increase budgetary support.
2. Issue an executive order formally reactivating the National Security Council....making this body fully operational and effective.
3. Set up the machinery for the amnesty and rehabilitation program for rebel returnees.
4. Investigate insurgent human rights violations.
5. Develop a government position (game plan) on the cease-fire talks with the NDF.
6. Replace inept and hostile "Officer in Charge" governors and mayors.
7. Replace inadequate and inefficient Cabinet members.
8. Conduct a campaign against graft and replace corrupt officials.
9. Formulate a positive policy and action plan for an effective government information and counterpropaganda drive.
10. Promote a spirit of reconciliation and national teamwork.

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